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STATE OF CALIFORNIA

NEW MOTOR VEHICLE BOARD

In the Matter of the Protest of CALIFORNIA NEW CAR DEALERS ASSOCIATION, Protestant, v. JAGUAR LAND ROVER NORTH AMERICA, LLC, Respondent.	PROTEST NO. PR-2463-16 **PROTESTANT CALIFORNIA NEW CAR DEALERS ASSOCIATION'S POST-HEARING OPENING BRIEF**

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PROTESTANT'S POST-HEARING OPENING BRIEF

I. INTRODUCTION

This is a case of first impression for the New Motor Vehicle Board (the "Board") based on recently enacted legislation sponsored by protestant the California New Car Dealers Association's (the "CNCDA"). The legislation permits certain associations of new motor vehicle dealers to challenge the legality of respondent Jaguar Land Rover North America, LLC's ("JLRNA") export and sale-for-resale prohibition policy (the "Policy"). In fact, JLRNA was the impetus for the law. After the Legislature enacted in 2013 California Vehicle Code section 11713.3, subdivision (y)[1], also sponsored by the CNCDA, to provide greater protection to dealers that faced serious penalties under unreasonable export and sale-for-resale prohibition policies, JLRNA's policies did not come into compliance with the new law. But no single dealer stepped forward to enforce it (only so that others would benefit). So the CNCDA has stepped up, not only to sponsor new legislation to bolster the statute, but also to follow through and actually challenge the unlawful Policy on behalf of Jaguar and Land Rover dealers.

This effort already has proven to be fruitful. JLRNA admits that the Policy violates Section 11713.3, subdivision (y)(3). This alone renders the policy void and unlawful. But the CNCDA seeks a Board declaration that the Policy violates Subdivisions (y)(1) and (2) as well, which it does.

JLRNA cannot take or threaten to take any adverse action against a dealer under the Policy, unless that dealer knew or reasonably should have known that the customer intended to export or resell the vehicle. Yet the Policy permits JLRNA to perform or threaten to perform a broad Step 2 audit of dealer records for *all* incentive programs, not just for exports, simply if it finds that a dealer exceeded a certain quarterly export threshold set under the Policy, regardless of the dealer's knowledge or constructive knowledge. While the intrusive audit itself constitutes an "adverse action," it also amounts to a *de facto* penalty: every California dealer subject to a Step 2 audit, even the four dealers for exceeding the Policy's threshold, was assessed some chargeback.

[1] Unless otherwise indicated, all statutory references are to the California Vehicle Code.

JLRNA violates Subdivision (y)(1) also because the Policy threatens to impose severe penalties upon a dealer if it "fails to conduct an adequate level of due diligence," not if the dealer knew or reasonably should have known of a customer's intent to export or resell per the statute, and regardless of whether the statutory presumption applies. As it turns out, the Policy's standard is so vague and unworkable that even JLRNA's own auditors have abandoned it altogether, and instead follow the statute's knowledge or constructive knowledge standard to assess penalties. To complicate matters, the Policy incorporates, what it refers to as, "Retailer Due Diligence and Best Practices" and "Indicators of Potential Export or Broker Behavior," which enumerate 62 prophylactic practices and "red flags" that JLRNA emphatically asserts are mere suggestions and not required under the Policy, despite the Best Practices' apparent "due diligence" misnomer coinciding with the Policy's "adequate level of due diligence" requirement. Nevertheless, the Policy implicitly requires dealers to comply with them to meet its purposely vague standard, or otherwise face the threat of penalties. In practice, however, JLRNA will assess penalties only if it finds evidence of certain "smoking guns," a fact that JLRNA never communicated to dealers.

Based on those Best Practices and Indicators, the Policy implicitly requires dealers to make further inquiries into a customer's intent, identity, or financial ability based on characteristics protected under the Unruh Civil Rights Act, in violation of Subdivision (y)(2). As a first line of inquiry, a prudent dealer that complies with the numerous and burdensome federal and California requirements in the ordinary course of every sales transaction can more than adequately ferret out exporting activity. The Best Practices and Indicators, however, implicitly require the dealer to do more by, for example, researching the customer online, searching for ties with international businesses or financing, or confirming that a customer possesses a U.S. driver's license. Though those practices may not be outright discriminatory, they act as proxies for inquiry into national origin, citizenship, or immigration status in violation of the statute.

As for Subdivision (y)(3), JLRNA already admits that the Policy fails to expressly include a provision stating the dealer's rebuttable presumption if the dealer causes the vehicle to be registered in this or any other state and collects or causes to be collected any applicable sales or use tax. This violation is not disputed.

For these reasons, the Board should sustain this protest and declare that JLRNA violated Section 11713.3, subdivisions (y)(1), (2), and (3), rendering the Policy void and unenforceable.

II. STATEMENT OF RELEVANT FACTS

A. The CNCDA Sponsored Legislation to Stop JLRNA's Unlawful Policy.

The CNCDA is composed of approximately 1,150 franchised new car dealer members, around 30 of which are Jaguar and Land Rover dealers. (Protestant's Propose Findings of Fact ["Fact"] ¶¶ 26-27) As part of its mission to protect its members' rights, the CNCDA will review state franchise statutes to determine if California's need improvement. (Fact ¶ 28)

In 2013, the CNCDA found that California lacked a rebuttable presumption-type statute that other states enacted to protect dealers with respect to exports. (Fact ¶ 29) So in 2014 California also enacted one in response. (Fact ¶ 30) In direct contravention of that statute, however, JLRNA maintained a "strict liability" exporting policy that threatened to take adverse action against a dealer if it exceeded a certain number of exported vehicles regardless of whether the presumption applied. (Fact ¶¶ 31-32)

JLRNA's blatant disregard of the law motivated the CNCDA to sponsor a bill in 2015, known as Assembly Bill No. 1178, intended to strengthen and clarify the statute to combat policies like JLRNA's. (Fact ¶ 33) To enforce the new legislation, a task that no dealer intended to take solely upon itself, the CNCDA also sought association standing to challenge the legality of any distributor export policy before the Board. (Fact ¶¶ 34-35) The CNCDA's lobbying efforts proved to be successful; the Legislature enacted Sections 3085, 3085.2, and the improved 11713.3, subdivision (y) in its current form.

B. The Policy Threatens Dealers With Audit Based only on Cars Being Found Overseas, Even if the Dealer Neither Knew nor Reasonably Should Have Known of a Customer's Intent to Export.

Before the new and amended statutes went into effect, JLRNA maintained an export and sale-for-resale prohibition policy providing that if a dealer exceeded its quarterly export threshold, then the dealer "would automatically be charged back" for margins and incentives, among other things. (Fact ¶ 37) JLRNA then revised it and implemented the Policy on December 10, 2015. (Fact ¶ 38) The Policy applies to all of JLRNA's approximately 165

Jaguar/Land Rover dealers in the U.S, and equally to Jaguar dealers as it does to Land Rover dealers. (Fact ¶¶ 39, 40) JLRNA does not maintain a separate policy in California. (Fact ¶ 39)

Under the Policy, JLRNA implemented two major changes.

First, JLRNA replaced the prior policy's automatic charge back provision with the following: "Any retailer who exceeds its quarterly export threshold will not be selected for a Step 2 audit of its sales transactions, including but not limited to the exported VINs [vehicle identification numbers]." (Fact ¶¶ 44, 48) The quarterly export threshold is set at three percent of a dealer's sales volume in a quarter for dealers with 250 or more annual vehicle sales. (Fact ¶ 46(a)) For those with less than 250 annual sales, the threshold is set at two exported vehicles per quarter. (Fact ¶ 46(b)) An "export" under the Policy generally is defined as any Jaguar or Land Rover purchased in, and exported from, the U.S. within nine months of the new vehicle retail date. (Fact ¶ 45)

To determine if a dealer exceeds its quarterly export threshold, JLRNA reviews sources, including the National Insurance Crime Bureau, the PIERS report, and the "China file," that show vehicles that have been exported from U.S. ports, or in the case of the "China file," vehicles that have been imported into certain countries (not just China). (Fact ¶ 47) JLRNA then cross-references VINs identified by those sources with the VINs within JLRNA's system to determine which dealer sold the vehicle and when it was originally sold. (Fact ¶ 47) That information is then used to calculate the dealer's percentage of exports by dividing it by the number of retail sales the dealer had for the quarter. (Fact ¶ 47)

According to the Policy, the Step 2 audit is not limited to review of only the VINs exported within the quarter, or just to determine compliance with the Policy, but instead includes a broad review of sales transactions for compliance with other contest and incentive programs and the Business Builder Program, JLRNA's variable margin program. (Fact ¶¶ 49-51) Nor does a Step 2 audit, triggered by the Policy, limit, in any way, JLRNA's right to perform any additional audits for any other reason. (Fact ¶ 52)

Second, the Policy introduced the concept of requiring a dealer to exercise an adequate level of due diligence or face penalties for violating the Policy. (Fact ¶ 54) Without further explanation, the Policy provides, "A retailer who fails to conduct an adequate level of due diligence in a sale to an exporter or broker is a violation of this Amended Export Policy. A retailer due diligence efforts, including proof of payment, at the time of sale must be retained in the deal jacket." (Fact ¶ 53)

In connection with a dealer's due diligence, though apparently not required, the Policy provides that a dealer should check any sales transactions against the names and addresses on the Known Exporter List and the Prospect Research Tool, or "PERT," for potential export sales. (Fact ¶ 55) The Known Exporter List is compiled by JLRNA, and as its name suggests, lists names and addresses of individuals associated with exported vehicles identified by JLRNA from its export sources. (Fact ¶ 56) Similarly, PERT permits a dealer to perform a free-form search to determine if any inputted information is associated with multiple purchases of Jaguar or Land Rover vehicles. (Fact ¶ 57) JLRNA maintains, however, that the Known Exporter List and PERT are not intended to restrict to whom a vehicle may be sold. (Fact ¶ 55)

The Policy also provides, for "reference," the "Retailer Due Diligence and Best Practices" and "Indicators of Potential Export [or] Broker Behavior." (Fact ¶ 58) Both are incorporated into the Policy. (Fact ¶ 59) JLRNA "strongly recommends" its dealers to follow a total of 44 "best practices" in identifying potential exporters. (Fact ¶ 62) Some of those Best Practices include:

- "Search all customer information (including names and addresses) against JLRNA's Known Exporter List";
- "Search for the customer online via Google or Bing";
- "Search for the customer's Linkedin or Facebook pages which may reveal more about them"; and
- "Look for any connections to businesses (especially automotive industry or international".

(Fact ¶ 62) JLRNA also identified eighteen "red flags" that the dealer and its employees "should recognize" as indicators of possible exporter or broker behavior, one of which is whether "[t]he buyer does not have a U.S. Driver's License." (Fact ¶ 63)

If a dealer fails to exercise an adequate level of due diligence, the Policy enumerates five penalties that JLRNA can assess for each exported for which the dealer did not meet that standard, though that list is not exhaustive. (Fact ¶¶ 60, 61)

Despite those major changes, JLRNA barely communicated, or hardly explained, them to its dealers. To date, JLRNA only has posted the Policy in its operational bulletin and briefly discussed it in its "Big 5 Call" with all of its dealers. (Fact ¶¶ 41-42) Notably, the Big 5 Call presentation only references removal of the automatic chargeback and makes no mention, let alone an explanation, of the Policy's "adequate due diligence" standard. Other than those methods of communication, JLRNA did not communicate or otherwise clarify the Policy to its dealers in any way. (Fact ¶ 43)

C. Every California Dealer Selected for Audit Based on the Export Threshold Has Been Charged Back.

To enforce the Policy, JLRNA's sales operations office determines if a dealer exceeds its quarterly export threshold based on the number of exports from the originating dealer. (Fact ¶ 64) Generally after a dealer is selected, the auditor will arrive at the dealer with a pre-prepared list of VINs and request that the dealer pull the sales jackets for each of them. (Fact ¶ 67) That process of pulling deal jackets by the dealer can go on for more than one day. (Fact ¶ 68) During the audit, the auditor will reach out to the dealer personnel to ask them to perform certain research or find certain documents, and discuss "exceptions," referred to as items subject to chargeback, with them. (Fact ¶ 69) After the auditor completes the "fieldwork," which typically lasts three days at the dealer, the auditor will draft the exit summary report that includes the findings of the audit. (Fact ¶¶ 70-71) The auditor also will have an exit meeting with the dealer to go over the initial findings." (Fact ¶ 70)

In performing an audit, JLRNA does not need to review original documents if scanned copies of sales jackets are legible and adequate. (Fact ¶ 73) So occasionally, JLRNA will perform remote audits where it requests a dealer to provide documentation to support specific VINs in questions rather than have an auditor physically visit the dealer. (Fact ¶ 72) This less intrusive audit also applies for potentially brokered or exported sales. (Fact ¶ 72)

In California alone, JLRNA already has selected four dealers for a Step 2 audit for exceeding their quarterly export threshold under the Policy, which, according to JLRNA, does not constitute as one of its random audits permitted under California law.. (Fact ¶¶ 65-66, 82) After concluded those audits, JLRNA assessed a chargeback for one reason or another against all four California dealers. (Fact ¶ 83) And to JLRNA's knowledge, no Step 2 audit of *any* California dealer *ever* resulted in a zero chargeback. (Fact ¶ 84)

III. <u>THE CNCDA CAN CHALLENGE THE LEGALITY OF THE POLICY BY THIS PROTEST, AND THE BOARD CAN HEAR AND DECIDE IT.</u>

An association, on behalf of two or more dealers subject to a factory export or sale-for-resell prohibition policy under Section 11713.3, subdivision (y), can challenge that policy by filing a protest with the Board. (Veh. Code § 3085, subd. (a).) And the Board has a duty to hear and decide such protest (*id.* § 3050, subd. (d)), though the relief it can provide is limited to a declaration that a policy violates the prohibitions of Section 11713.3, subdivision (y). (*Id.* § 3085, subd. (b).) The burden of proof falls on the association to show that the policy violates that statute. (*Id.* § 2085, subd. (d).)

The parties do not dispute that the CNCDA has standing to bring this protest and to challenge the Policy's legality. (Fact ¶ 22) The Board therefore can declare that the Policy violates Section 11713.3, subdivision (y), and is void and unenforceable.

IV. <u>ARGUMENT</u>

Section 11713.3, subdivision (y) has three prohibitions.

First, Subdivision (y)(1) prohibits JLRNA from taking or threatening to take adverse action against a dealer pursuant to the Policy because a customer of a dealer exported or sold a vehicle for resale, unless the dealer knew or reasonably should have known of that intent.

Second, Subdivision (y)(2) prohibits the Policy from expressly or implicitly requiring a dealer to make further inquiries into a customer's intent, identity, or financial ability to purchase or lease a vehicle based on any of the customer's characteristics listed or defined under Section 51 of the Civil Code – the Unruh Civil Rights Act.

Third, Subdivision (y)(3) requires the Policy to include an express provision stating a dealer's rebuttable presumption – that a dealer does not violate the statute if it causes the vehicle to be registered in this or any other state and collects or causes to be collected any applicable sales or use tax.

The Policy violates all three, and in the case of Subdivision (y)(1), for two reasons. The Step 2 audit constitutes an "adverse action," and the Policy permits JLRNA to audit or threaten to audit a dealer based on the "strict liability" quarterly export threshold, regardless of the dealer's knowledge. The Policy's "adequate level of due diligence standard" additionally is purposefully vague and imposes a greater burden on a dealer than the statute's knowledge requirement. The Policy also violates Subdivision (y)(2) because dealers will presume that they must comply with Best Practices and Indicators, some of which act as proxies for inquiry into protected characteristics such as national origin, citizenship, or immigration status. And the Policy violates Subdivision (y)(3) because JLRNA already admits that it does.

A. <u>The Policy Violates Subdivision (y)(1).</u>

1. *The Policy Threatens Adverse Action Based only on Vehicles Being Found Overseas, Regardless of a Dealer's Knowledge or Constructive Knowledge.*

No dealer has ever asked JLRNA to audit it. (Fact ¶ 80). No doubt because audits are unpleasant, disruptive, and take away dealer personnel's time and focus. (Fact ¶ 75) In particular, dealer staff are required to pull sales jackets for the auditors, assist in the audit, and then go through the material with auditors to answer their questions. (Fact ¶¶ 67-71, 75) This process of pulling sales jackets sometimes requires over a day of a dealer's time and resources, and the audit itself typically lasts three days. (Fact ¶¶ 67-71, 75) That involves an economic cost, a focus cost, and an operational cost. (Fact ¶ 75)

Even Andrew Polsinelli, JLRNA's National Sales Operations Manager, admitted that he, personally, would not want to be audited. (Fact ¶ 81) Indeed, according to Mr. Polsinelli, dealers have an incentive to follow the Best Practices and Indicators to stay below their quarterly threshold to avoid being selected for a Step 2 audit. (Fact ¶ 79) It therefore comes as no surprise that the Step 2 audit ostensibly constitutes an "adverse action."

To be sure, Alan Skobin, the CNCDA's expert witness, explained why based on his over 40-years' experience in the automobile industry and as Vice President and General Counsel for the fourth highest volume, California-based Jaguar dealer in the country. He opined that the Step 2 audit constitutes an adverse action under the statute, because the audit threatened is not limited to the units found overseas, but instead is unlimited in scope. (Fact ¶ 74) To support that opinion, he found that the Policy does not provide that JLRNA will narrowly inquire into only those records of vehicles it has found to be exported if a dealer exceeds it threshold; rather, the Policy threatens a Step 2 audit that goes far beyond just exported vehicles. (Fact ¶ 76) According to Mr. Skobin, the more reasonable approach would be to conduct a narrow inquiry into only those sales jackets for exported vehicles if a dealer exceeded its threshold. (Fact ¶ 77)

JLRNA disagrees, however, because it claims the law permits it to conduct audits on a reasonable basis, so long as a dealer is not selected for an audit, or the audit is not performed in a punitive, retaliatory, or unfairly discriminatory manner. (See Veh. Code § 3065.1, subd. (g)(1).) But suspected export violations do not constitute a reasonable basis to conduct an overbroad Step 2 audit, which includes review of nine months' of sales jackets and for all contest and incentive programs and the Business Builder Program, because the audit is disproportionate to the purported violations. As Mr. Skobin explained, suspected export violations provide a reasonable basis to audit those sales jackets alone. (Fact ¶ 77) And though JLRNA may claim it lacks the resources to visit a dealer for such a narrow audit, its own audit policy, however, permits it to conduct remote audits specifically for suspected export or broker violations. (Fact ¶ 72) JLRNA offers no reason why the audit cannot be narrowly tailored.

The Step 2 audit also is intended to be punitive. Before the Policy, JLRNA would penalize a dealer for exceeding the quarterly export threshold by imposing an automatic chargeback. (Fact ¶ 37) The Step 2 audit now replaces that punitive provision. This, again, is why Mr. Polsinelli believed that dealers have an incentive to stay below the threshold – to avoid an audit altogether. Indeed, a dealer selected for a Step 2 audit is virtually guaranteed to be assessed a chargeback, as evidenced by the four California dealers audited for exceeding the threshold. (Fact ¶ 83) Quite simply, if JLRNA performs a Step 2 audit, then the dealer will be assessed a chargeback for one reason or another. The Step 2 audit therefore is a *de facto* penalty.

Though the audit constitutes an "adverse action," the Policy unlawfully permits JLRNA to proceed with or threaten it without accounting for a dealer's knowledge of an export or broker circumstance. Instead, the audit is triggered by a dealer exceeding its quarterly export threshold, a purely formulaic determination based solely on the number of discovered exports originating from a particular dealer. JLRNA does not dispute that.

Mr. Skobin further explained that the Policy, on its face, undoubtedly threatens the Step 2 audit. The relevant provision in the Policy reads, "Any retailer who exceeds its quarterly export threshold *will* not be selected for a Step 2 audit of its sales transactions … ." (Fact ¶ 78 [emphasis added]) The operative language in that provision, "will," infers certainty of an audit. Though JLRNA argues that it cannot actually audit every dealer that exceeds the threshold because it lacks resources, that is irrelevant, because just the threat of taking "adverse action" in this circumstance is prohibited. For this reason, JLRNA violates Subdivision (y)(1).

2. *The Policy's Requirement for a Dealer to Exercise an Adequate Level of Due Diligence on Penalty of Being Deemed in Violation of the Policy and thus Subject to Charge Back Constitutes a Threatened Adverse Action in Violation of the Statute's Knowledge Requirement.*

Mr. Skobin opined that a dealer should not knowingly participate in activities that would result in vehicles being exported in contradiction of factory policy, because it is detrimental for many reasons to the dealer, the factory, and the end customer. (Fact ¶ 85) The parties do not dispute that. (Fact ¶ 24) And Mr. Skobin's opinion is consistent with the statute's requirement that JLRNA cannot take or threaten adverse action unless the dealer knew or reasonably should have known of an export situation. But the Policy is inconsistent with that standard on its face, because it instead requires a dealer to exercise an "adequate level of due diligence." (Fact ¶ 53)

To provide some context, Mr. Skobin explained that an automobile sales transaction in California is already complicated and imposes many requirements on a dealer. (Fact ¶ 89) He discussed the burdensome steps that a dealer must go through in the ordinary course of every sales transaction. Generally, a dealer needs to learn about the customer's vehicle requirements to help them select the right vehicle, which is also a reason why a customer typically would test drive a vehicle. (Fact ¶ 87) In connection with financing, a dealer typically will have the customer complete a credit transaction and run a credit bureau. (Fact ¶ 87) They also always run a search through the Office of Foreign Assets Control to determine if the customer or financer is included in the government's prohibition list. (Fact ¶ 87) And a dealer will look for "red flags," which are discrepancies in income, Social Security number, address, age, date of birth, or other similar identifying characteristics. (Fact ¶ 87) These extensive inquiries in the ordinary course typically flush out any improper purpose for the vehicle purchase, such as exporting or brokering. (Fact ¶ 88) Therefore, absent any evidence that the vehicle is to be used other than for the customer's use, a dealer is not going to interrogate that customer and instead continue and complete the transaction because the process is already so thorough. (Fact ¶ 90)

Based on that background, Mr. Skobin opined that if a dealer is reasonably prudent in the ordinary course of every sales transaction, and also keeps their eyes open for any indication of exporting or other improper activity during the transaction, that is being reasonable or doing proper due diligence in terms of whether the dealer knew or should have known of the customer's intent to export the vehicle. (Fact ¶ 86) Requiring further steps over the already burdensome ordinary steps is unduly burdensome and disruptive. (Fact ¶ 86)

Yet the Policy's "adequate level of due diligence" standard imposes a significantly greater burden on dealers, particularly because of the Best Practices and Indicators that the Policy incorporates. (Fact ¶ 92) While JLRNA argues that those are only recommendations, based on the totality and in real would application, however, a dealer would construe them to be mandatory. (Fact ¶ 95) From the dealer perspective, the Best Practices and Indicators would raise a serious concern for the dealer if it did not perform a number of them, because that guidance and recommendation comes directly from JLRNA. (Fact ¶ 95) A dealer therefore would believe that the Best Practices and Indicators would be used against it if a vehicle was exported but the dealer did not follow them. (Fact ¶ 95)

So Mr. Skobin concluded that the Policy implicitly requires a dealer to perform the Best Practices to meet the Policy's adequate due diligence standard, because conversely, JLRNA can, in hindsight, conclude that a dealer did not meet that standard by failing to perform them. (Fact ¶ 93) JLRNA's determination of whether a dealer exercises an adequate level of due diligence is consistent with that opinion; its auditors reference the Policy itself with the various due diligence recommendations and search for whether the dealer has performed some Best Practices as well as for Indicators. (Fact ¶¶ 94, 102)

But the Policy does not give clear guidance on what an "adequate level of due diligence" is, particularly because the Policy includes so many things that are neither helpful nor realistic in the sales world, given the complexity of the sales transaction. (Fact ¶¶ 91) Mr. Skobin discussed several examples of unrealistic Best Practices and Indicators. For instance, he is unaware of anyone searching alternate phone numbers captured in caller ID. (Fact ¶ 97) He has never heard of a non-financial lien for cash transactions, nor is he aware of any standardized form in the industry. (Fact ¶ 98) Searching the Known Exporter List delays the customer, diverts focus from the core of the transaction, and is inappropriate unless the dealer has some suspicion or reason to check. (Fact ¶¶ 99-100) And though Mr. Skobin also attempted to explore the PERT tool, he could not even find it. (Fact ¶ 101) He therefore opined that the Policy's Best Practices are not realistic or practical in the sales process unless there is cause for suspicion. (Fact ¶ 96)

The Policy's lack of clear guidance has proven to be confusing also for JLRNA's own auditors. In practice, the auditors dispense with the Policy's "adequate level of due diligence" standard, and instead they hold themselves to a higher standard of establishing that the dealer knew or should have known the vehicle was an export situation to constitute a Policy violation. (Fact ¶ 102) Michael Stern, JLRNA's Retail Audit Manager, admitted that there is a difference between the "adequate level of due diligence" standard and the "knew or should have known" standard in the context of the Policy. (Fact ¶ 104) Both Mr. Skobin and Mr. Stern agree that the "adequate level of due diligence" standard creates practical enforcement issues, because some due diligence efforts cannot be documented or otherwise would not be found upon reviewing sales jackets. (Fact ¶ 105) JLRNA therefore cannot determine if a dealer performed certain due diligence efforts. (Fact ¶ 105)

Instead, the auditors adopted the "knew or should have known" standard to determine compliance with the Policy based on discovery of some tangible documentation. (Fact ¶ 106) In practice, the auditors will look for a "smoking gun" document in a deal jacket demonstrating that a dealer know or should have known that a vehicle was in an export situation. (Fact ¶ 103) Mr. Stern listed all known examples of "smoking guns:" a shipping document, a wire transfer from an exporting company, out-of-state customer that does not take delivery of the vehicle, a customer that was on the Known Exporter List, a cashier's check with a remitter from someone completely different than the customer, no sales jacket, and a customer that is a used car dealership that does not register the vehicle or pay sales tax. (Fact ¶ 107) But as Mr. Stern admitted, none of those "smoking gun" examples are communicated to the dealers. (Fact ¶ 108)

And there lies the problem with the Policy's "adequate level of due diligence" standard. JLRNA's lack of communication about the Policy creates a fundamental disconnect between JLRNA's actual standard for enforcement of the Policy, and the dealer's perception of JLRNA's expectations under "adequate level of due diligence" standard. The Policy is purposely vague to induce dealers to exercise a higher level of due diligence than actually required or risk facing stiff penalties. In reality, however, JLRNA imposes penalties only if a dealer knew or should have known of an export situation based solely on any of the "smoking guns" listed by Mr. Stern – a much smaller list than the 63 Best Practices and Indicators. If JLRNA communicated that, then it would guide dealers to look only for "smoking guns" to avoid penalties. But because dealers perceive that they are held to a higher standard of care than the "knew or should have known" standard actually enforced, and therefore feel compelled to perform the Best Practices and search for Indicators, the Policy conversely threatens penalties against the Dealer based upon a lower scienter standard than the statute. For this separate reason, the Policy violates Subdivision (y)(1).

Finally, for the avoidance of doubt, even at the most basic level, the Policy threatens chargebacks based on a degree of care that, as a matter of law, exceeds the standard of care dictated by statute. "Constructive knowledge" is defined as "[k]nowledge that one using reasonable care or diligence should have, and therefore that is attributed by law to a given person." *Knowledge*, Black's Law Dictionary (10th ed. 2014). Thus, the "should have known" standard is equated in this definition to the term constructive knowledge and refers to the use of reasonable care and diligence, exactly squaring with the statutory requirement of "knew or reasonably should have known."

However, "due diligence" is defined as "[t]he diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation," while "reasonable diligence" is defined as a "fair degree of diligence expected from someone of ordinary prudence under circumstances like those at issue." *Diligence*, Black's Law Dictionary (10th ed. 2014). Thus, the "should have known" standard equates with "reasonable diligence," whereas "due diligence" equates with some higher standard of inquiry, based on a particular obligation or legal requirement. And while the foregoing shows that the statutory standard of care is exceeded merely by references to "due diligence," the Policy's addition of the phrase "adequate level," and the Best Practices and Indicators, clearly depart from the statutory requirement, all to the detriment of the dealer's rights under the statute. The Policy's statements that chargebacks or other adverse consequence will or may follow a failure to exercise an adequate level of due diligence therefore constitute threats by JLRNA to take adverse action without the requisite statutory knowledge or constructive knowledge. Specifically, the Policy's statement that a lack of adequate due diligence violates the Policy (and thus merits a charge back) is clearly a threat to charge back in violation of the statute.

B. The Policy Violates Subdivision (y)(2) Because It Implicitly Requires Dealers to Make Further Inquiry into a Customer's Intent, Identity, or Financial Ability Based on Protected Characteristics.

Mr. Skobin explained that the first line of inquiry conducted in the ordinary course of business is so extensive and probing that further inquiry, absent something that triggers an issue, is inappropriate. (Fact ¶ 109) He opined that an export policy therefore should not require a second line of inquiry of the customer, unless there is cause for suspicion. (Fact ¶ 110)

But the Policy goes well beyond the first line of inquiry in the ordinary course of business. It implicitly requires dealers to perform the Best Practices and search for Indicators, many of which, as Mr. Skobin said, are unrealistic or unheard of in the ordinary course. (Fact ¶¶ 112)

The Best Practices and Indicators therefore constitute the further inquiry into a Customer's intent, identify, or financial ability.

The statue prohibits such inquiry if based upon "*any*" of the protected characteristics under the Unruh Civil Rights Act. It does not, however, require a finding of discriminatory intent of any kind; rather, the inquiry simply needs to be based upon any of the characteristics, such as "national origin," "citizenship," or "immigration status." (See Civ. Code § 51, subd. (b).) Several of the Best Practices and Indicators specifically are based, at least implicitly, on these characteristics, particularly those that seek to apply more scrutiny on international customers. Just as in discrimination cases, protected characteristics are often involved indirectly, where other factors act as proxies that impact individuals having protected characteristics. For instance, the Best Practices impliedly require a dealer to search for ties to international businesses, and to determine if funding originated outside the U.S. (Fact ¶ 113). These requirements clearly place more scrutiny upon customers with international ties and thereby implicitly are based on citizenship and immigration status. A buyer that does not have a U.S. Driver's License is to be scrutinized more carefully under the Policy, and this clearly imposes more scrutiny on those whose immigration status or foreign citizenship prevents them from having a U.S. license. (Fact ¶ 113) Other Best Practices, such as searching for the customer on Google or Bing and reviewing their social media, though not as direct, can lead to the same nefarious result as the more obvious ones. (Fact ¶ 113)

Mr. Skobin explained why inquiry that simply touches protected characteristics can be problematic for dealers. He opined that the Policy's Best Practices can result in an unpleasant car buying experience for legitimate customer by upsetting the customer. (Fact ¶ 115) For example, a dealer's inquiry into recent funding of a customer's account or a customer's financial information, is not only unrealistic and unproductive, but also detrimental to the dealer's relationship with the customer, particularly when there is no reason to do so. (Fact ¶ 117) A dealer that is expected to interrogate a legitimate customer that raises no suspicion, and treat the customer like a suspect, creates an unpleasant situation because of, what a customer may believe to be, inappropriate inquiry. That can also impact a dealer's customer satisfaction index, or

"CSI," score, which also can have negative financial and reputational ramifications to the dealer. (Fact ¶ 116)

Because the Best Practices and Indicators implicitly require further inquiry into a customer's intent, identity, or financial ability based upon protected characteristics, JLRNA violated Subdivision (y)(2).

C. The Policy Violates Subdivision (y)(3) Because It Does Not Contain an Express Provision Stating a Dealer's Rebuttable Presumption.

JLRNA already admits that the Policy does not contain the requisite statutory language and needs to amend it to comply. (Fact ¶ 23) The Policy therefore violates Subdivision (y)(3), rendering it void and unenforceable.

V. CONCLUSION

JLRNA violates every provision of Vehicle Code section 11713.3 subdivision (y). First, the Policy imposes or threatens to impose the adverse action of a Step 2 Audit based on a quarterly export threshold that does not account for a dealer's knowledge. As a separate violation of Subdivision (y)(1), JLRNA also threatens to penalize a dealer for an export violation based on an "adequate level of due diligence" standard that requires lower scienter than the "knew or should have known" standard under the statute. Second, the Policy violates Subdivision (y)(2) because the Best Practices and Indicators implicitly require a dealer to make a further inquiry into customer's intent, identity, and financial ability based on protected characteristics under the Unruh Civil Rights Act. Third, JLRNA admits that the Policy does not expressly state a dealer's statutory rebuttable presumption in violation of Subdivision (y)(3).

For these reasons, the CNCDA respectfully requests that the Board sustain this protest, declare that the Policy violates Section 11713.3, subdivision (y), rendering the Policy void and unenforceable.

Dated: March 13, 2017

ARENT FOX LLP

By:______________________
Halbert B. Rasmussen
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Attorneys for Protestant
CALIFORNIA NEW CAR DEALER ASSOCIATION

In the Matter of the Protest of:
California New Car Dealers Association vs. Jaguar Land Rover North America, LLC
Protest No. PR-2463-16

PROOF OF SERVICE

I am a citizen of the United States. My business address is Arent Fox LLP, 555 West Fifth Street, 48th Floor, Los Angeles, California 90013-1065. I am employed in the County of Los Angeles, where this service occurs. I am over the age of 18 years, and not a party to the within cause.

On the date set forth below, according to ordinary business practice, I served the foregoing document(s) described as:

PROTESTANT CALIFORNIA NEW CAR DEALERS ASSOCIATION'S POST-HEARING OPENING BRIEF

☐ (BY FAX) I transmitted via facsimile, from facsimile number 213.629.7401, the document(s) to the person(s) on the attached service list at the fax number(s) set forth therein, on this date before 5:00 p.m. A statement that this transmission was reported as complete and properly issued by the sending fax machine without error is attached to this Proof of Service.

☒ (BY E-MAIL) On this date, I personally transmitted the foregoing document(s) via electronic mail to the e-mail address(es) of the person(s) on the attached service list.

☒ (BY MAIL) I am readily familiar with my employer's business practice for collection and processing of correspondence for mailing with the U.S. Postal Service, and that practice is that correspondence is deposited with the U.S. Postal Service the same day as the day of collection in the ordinary course of business. On this date, I placed the document(s) in envelopes addressed to the person(s) on the attached service list and sealed and placed the envelopes for collection and mailing following ordinary business practices.

☐ (BY OVERNIGHT DELIVERY) On this date, I placed the documents in envelope(s) addressed to the person(s) on the attached service list (New Motor Vehicle Board Only), and caused that envelope to be delivered to an overnight delivery carrier, Federal Express, with delivery fees provided for, for next-business-day delivery to whom it is to be served.

☒ (State) I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on March 13, 2017 at Los Angeles, California.

LouAnn Crosby

LouAnn Crosby

In the Matter of the Protest of:
California New Car Dealers Association vs. Jaguar Land Rover North America, LLC
Protest No. PR-2463-16

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